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THE OBJECT OF THE CREDIT UNION

A Reply to MYRON T. HERRICK

BY

ARTHUR H. HAM

Reprinted from the
New York Sunday Times, May 7, 1916

BY THE

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RUSSELL SAGE FOUNDATION
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JULY, 1916

SOME PUBLICATIONS ON COOPERATIVE CREDIT ISSUED BY RUSSELL SAGE FOUNDATION

No. 5. Cooperative Credit. A Selected Bibliography. Bulletin of Russell Sage Foundation Library, June, 1914. (5 cents.)

RL 15. A Credit Union Primer. By Arthur H. Ham and Leonard G. Robinson.

Contains a brief history of cooperative credit, a definition of its field in the United States, an outline of the elementary principles of credit unionism, together with model by-laws, necessary books and forms, instructions for organizing, and the New York credit union law.

Division of Remedial Loans. 79 p. 1914. (25 cents.)

RL 16. The Cooperative People's Bank. By Alphonse Desjardins.

The evolution of the cooperative bank, the Canadian system, its growth and accomplishments.

Division of Remedial Loans. 42 p. 1914. (15 cents.)

RL 19. Credit Unions and their Relation to Savings and Loan Associations. By Arthur H. Ham.

An address delivered before the State League of Savings and Loan Associations, Port Jervis, N. Y., June 10, 1915.

Division of Remedial Loans. 12 p. 1915. (Single copies free.)

RL 22. Determining Credit. A Suggestive Method for Credit Committees of Credit Unions. Devised by R. S. Hale.

Division of Remedial Loans. 8 p. 1916. (Single copies free.)

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THE OBJECT OF THE CREDIT UNION

IN 1913 the State of New York enacted a law permitting groups of individuals, associated by reason of residence, occupation, fraternal association or otherwise, to join in the organization and operation of credit unions under the supervision of the State Banking Department. The agency contemplated by this statute is an adaptation of Canadian and European types of cooperative credit associations designed to encourage thrift in a more effective manner than do existing agencies for saving, and to increase the opportunities of borrowing for legitimate purposes for people who can offer as security little but their good character. The law followed in many respects the credit union law of Massachusetts enacted in 1909, and has itself been copied in whole or in part by several other states. The genesis of this legislation was the success of the People's Banks in Canada first formed by M. Alphonse Desjardins in Levis, Quebec, in 1900, the number of which he has now increased to nearly 200.

The New York law was revised in 1914 and again amended in 1915. It was conceived as a flexible statute prescribing certain general regulations and restrictions, but permitting within these bounds such variations from the general plan as would suit the needs of individual groups. While the law is not considered to be in perfect shape and has never been held up as a model for adoption throughout the country, students of cooperative credit here and abroad have considered that it was formulated on right lines, and that its provisions warranted the organization of credit unions in certain localities of the State. As a matter of fact twenty-five have already begun business.

Now comes Myron T. Herrick, who condemns utterly this credit union law of New York, as well as those of Massachusetts, Oregon, North Carolina, Texas, Utah, and Wisconsin. He finds that each violates the basic principles of cooperation, and that together they are a "striking instance of good intentions gone wrong through immature thought and hasty action." He urges that they be "wiped off the statute books."

Mr. Herrick is a formidable critic because of his knowledge of cooperative credit systems and the wide circulation which has been given to his writings and speeches on this subject. His criticism, at first restrained, has of late become so vehement that it seems to call for an answer by some friends of the movement in this country lest the public grow to consider it as wholly bad and deserving of extinction. The credit union movement is too young yet to have become generally understood and accepted, but one cannot fail to remember that it required fifty years for the now well-known and widely appreciated building and loan association to become a popular institution in this country, and that in its early days it, too, had its critics as well as its defenders.

Mr. Herrick's criticisms may be summed up as follows:

The chief defect in these laws is that they are based on the mistaken assumption that cooperation is a benevolent or altruistic means of assisting distress and incompetence through the indulgent hand of government. This conception is shown in the exemption from taxation provided in all these laws.

The laws limit dividends to shareholders to 6 per cent. per annum—an unreasonable restriction which absolutely prevents the cooperative practices they were intended to encourage.

They all require members to be natural persons—none allows associational members—this restriction alone being sufficient to prevent the unions from becoming basic units of a rural banking and credit system for improving and strengthening the selling power of the members and supplying their financial needs.

They all forbid the acceptance of deposits from outsiders, thus closing the greatest source of funds for operations.

They all require share capital.

They prohibit the unions from doing any other business and from using their funds for any other purpose than that of making loans to individual members, thus preventing the unions from becoming part of a larger system for cooperative purchasing, etc., and so using their funds for the common good of their members.

They require credit unions to be formed as corporations, with share capital and limited liability of shareholders. By failing to permit unions to be formed as associations with or without shares, with collective liability limited or unlimited, they block the play of private initiative and freedom of action.

Their use of the word "union" is wrong and will precipitate into confusion the statutes and literature on the subject in European minds.

These objections are raised by Mr. Herrick, primarily with the farmer in mind, but neither does he find any good in the credit union for dwellers in cities. He says:

The efforts being made in the United States to induce wage workers and clerks to form such credit unions are hopelessly wrong; they are doomed to as bitter a failure as the other misguided efforts to repair through collective credit the fortunes of thriftless incompetents. There are depths to which it (the cooperative bank) cannot reach.

He holds that credit unions should make loans only for productive purposes, namely, to farmers to enable them to carry on their pursuits, and to trades people and artisans to assist them in conducting their businesses.

"Wage earners and clerks," he says, "can be interested in cooperative banking only as depositors." He cannot conceive of their borrowing for anything except a consumptive, or, at best, a provident purpose, and for this reason he advises those interested solely as investors to keep out of credit unions formed among wage earners and clerks.

An answer to this blanket denunciation necessitates a brief analysis of the credit union laws enacted in the United States and some comments upon conditions in our cities which have seemed to warrant the extension of cooperative banking to wage earners, clerks, and others whose credit facilities are inadequate, as well as to farmers and trades people.

TAX EXEMPTION

Under the laws of New York, Massachusetts, Oregon, Wisconsin, and North Carolina credit unions are exempt from taxation in the same manner that other institutions for savings are exempt. Under the laws of Texas and Utah they are not exempt. Mr. Herrick's statement as to general tax exemption, therefore, applies only to a certain part of the credit union laws now in effect. In spite of his objection, it is difficult to see why the exemption feature should not be included in all such laws.

The purpose of tax exemption is to encourage an activity or tendency particularly desirable in a community. If a town or city exempts an industry from taxation it does so because it desires that industry to locate within its limits on account of the

benefit which the town will derive from it. If the State exempts a thrift agency from taxation it does so because it considers thrift to be a desirable quality deserving encouragement among its citizens, not because it considers its clientele to be in need of benevolent assistance. Building and loan associations and savings banks are generally exempt from taxation. So far from considering these agencies as "benevolent attempts to assist thriftless incompetents," and their depositors as impecunious wards of the State living upon its bounty to the detriment of non-depositors, Mr. Herrick calls them excellent and likens their clientele to that of European cooperative credit associations.

RESTRICTION OF DIVIDEND

An examination of the credit union laws now in effect shows that Mr. Herrick's statement that "all these laws provide for tax-exempted, dividend-restricted organizations" is even less true as regards restriction of dividends than as regards tax exemption, for of the seven laws in effect only two limit dividends to shareholders, namely, those of North Carolina and Utah. The North Carolina law fixes a limit of 6 per cent.; the Utah law allows a liberal maximum of 2 per cent. in excess of the average rate charged upon loans. But in spite of Mr. Herrick's criticism there seem to be reasons why credit unions should adopt a limitation of dividend rate in order to encourage them to be really cooperative rather than dividend-hunting in character. Justification for this view is even to be found in Mr. Herrick's own writings, for in his book "Rural Credits" he says:

> Large dividends are objectionable and dangerous from the cooperative point of view. They come mostly from the borrowing members and add to their burdens, thus creating a conflict of interest within the bank. Hence many writers contend that they should not exceed the rate at which money may be procured in the open market. Unless some such restriction is imposed it is difficult for a people's bank to maintain its true character.

The credit union laws, therefore, do not, as a rule, merit Mr. Herrick's condemnation on the score of dividend limitation, and if they were to include such a limitation it would accord with Mr. Herrick's own previously expressed beliefs.

ASSOCIATIONAL MEMBERS

Even a cursory examination of the credit union laws largely dispels Mr. Herrick's criticism that "all require members to be natural persons; none allows associational members." The Utah law specifically provides for the admission of cooperative societies to membership in credit unions. The New York law requires the by-laws of credit unions to specify the qualifications of members; it says nothing about membership being limited to persons, and even though it did, corporations and associations might still be admitted, for they have been held to be included in the definition of "persons." The Massachusetts law requires the by-laws to specify the qualifications of "persons" for membership, but, as under the New York laws, the word is construed to include corporations and associations, as well as individuals. Massachusetts credit unions now operating admit persons, firms, corporations, and societies. One union, with the approval of the Banking Department, admits to membership "credit unions, civic, philanthropic, charitable or religious organizations, persons, firms, or corporations residing in or doing business in the State of Massachusetts." Credit union laws of other states seem to be open to the same construction, and afford no basis for this criticism of Mr. Herrick's.

DEPOSITS FROM NON-MEMBERS

The laws of Utah and North Carolina permit credit unions to accept deposits from non-members; the other laws do not. Failure to accept the deposits of non-members would be a pertinent criticism of the German people's bank of the Schulze-Delitzsch type since that organization requires each member to buy an expensive share, or of the Raiffeisen association, since it requires unlimited liability from its members. But it loses its force when applied to credit unions in the United States, for each of the laws, which require depositors to be members and reject deposits from outside, permits the by-laws of the union to fix the par value of shares. This usually ranges from $1 to $5. Surely a man willing to place money on deposit with a credit union would not be averse to subscribing for a dollar or five dollar share payable, if he wishes, on the installment plan at a few cents

weekly or monthly. No one can seriously believe that this requirement will keep would-be depositors away in any great numbers.

Nor does the ownership of shares involve great liability, for, unlike the rural credit associations of Europe, credit unions in the United States invariably limit the liability of members to the extent of their share holdings. In this respect they resemble the People's Banks of Italy and Canada. It remains to be seen whether Americans in rural or urban communities will be willing to associate, for the purpose of extending credit, in a cooperative enterprise which involves its members in unlimited liability. The evidence seems to point in the opposite direction.

Although most of the laws do not permit the receipt of deposits from non-members, they do permit unions to obtain outside funds by borrowing from non-members, and the New York, Oregon, and North Carolina laws are the only ones to place a limit upon such borrowing power—in New York and Oregon the sum is $2,000, or 40 per cent. of the share capital; in North Carolina it is an amount not exceeding the capital, surplus, and reserve.

SHARE CAPITAL

It is true that all the credit union laws require share capital, and each member of a credit union must be a shareholder, but the capital is variable. No fixed amount of capital is required to be subscribed at the start; shareholders may withdraw at will, and the capital increases and decreases as new members come in or old members withdraw. Each credit union may determine for itself the par value of its shares—except in Utah, where the law fixes the par value at $5. The requirement, therefore, that each member must hold at least one share cannot be considered burdensome, particularly as shares may be paid for in installments, and the cost of the share rarely exceeds $5, often being as low as $1.

LIMITATION OF POWERS

The prohibition against credit unions using their funds for any other purpose than that of making individual loans to members is, says Mr. Herrick, "the most serious and regrettable defect in the laws."

> It prevents them [credit unions] from becoming part of a larger system for cooperative production and purchasing * * * and absolutely prevents the cooperative practices they were intended to encourage. The cooperative bank buys supplies at wholesale and retails them to members at a lower price than they could obtain individually * * * it invests in shares and bonds of other cooperative associations. Clearly none of this is possible through the American credit unions.

It might well be contended that as credit unions may admit to membership associations formed for cooperative purchasing, etc., it does not matter whether or not the unions themselves are empowered to conduct such activities; but let us see whether Mr. Herrick's statement that they may not do so is borne out by facts.

The credit union of Utah, in addition to issuing shares, accepting deposits and making loans, is authorized by law to "otherwise employ its funds and undertake such other activities relating to its purpose as the by-laws may authorize." Almost identical language is found in the laws of Massachusetts, Wisconsin, North Carolina, and Texas, and at this moment credit unions in some of these states are purchasing supplies at wholesale for retail sale to members. The Massachusetts law permits credit unions to purchase bonds and shares of other cooperative associations; the New York and Oregon laws permit them to hold shares in and make deposits with other credit unions; the New York unions may purchase any securities that are legal investments for savings banks and they are given the "powers conferred by the general corporation law." It would seem, therefore, that these laws are open to such construction as would permit credit unions to engage in all the activities which Mr. Herrick deplores their inability to carry on. It is a question whether the laws do not give too much rather than too little power.

FORM OF ORGANIZATION

It is true that the laws provide for the incorporation of credit unions, but they are non-stock corporations and have none of the characteristics of joint stock companies. They have no fixed

capital and the voting unit is membership, not the number of shares held—one man, one vote; not one share, one vote. The credit union in New York State is as much associational in form as are the building and loan associations or savings banks referred to by Mr. Herrick. As regards liability, it is possible under all these laws for credit unions to require individual unlimited liability of members, if they so desire.

WAGE-EARNERS' AND CLERKS' CREDIT UNIONS

We are told by Mr. Herrick that efforts to form credit unions among wage-earners and clerks are "hopelessly wrong"; that cooperative credit is intended for farmers and tradesmen to enable them to carry on their individual businesses, but not to relieve distress. But already sufficient experience has been gained to indicate that it is not financially unsafe for clerks to form credit unions among themselves and to loan their accumulated funds to their fellows for purposes that promise to benefit them, provided the union does not depart from certain fundamental principles of operation. Space does not permit us to give detailed examples, but the fact that credit unions were formed during 1915 among the employes of the Postal Telegraph Company, the Mutual Life Insurance Company, the Equitable Life Assurance Society, and a dozen other industrial, fraternal, and neighborhood organizations in New York City is testimony to the esteem in which this form of cooperative financial association has already come to be held. Steps are now being taken to organize a series of credit unions among the army of employes of a large public service corporation. In the face of these illustrations one who opposes the extension of the cooperative idea to wage-earners and clerks will have to advance a more convincing objection than "it has not been encouraged in Europe." A sufficient answer to that objection would seem to be that the installment purchasing evil has not been developed abroad as it has here, and the salary loan shark is almost exclusively an American institution.

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